

Compliance with HMRC Tax Regimes from April 2006

Letter of 3 February 2006

This letter raises the following ***administrative and technical issues*** for consideration:

1. Unauthorised payments - compensatory added years
2. Other payments that may be unauthorised - such as gratuities, injury allowance and Crombie
3. Trivial commutation
4. Refund of excess contributions lump sum
5. Exceptional ill-health commutation
6. Annual allowance



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Creating sustainable communities

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3 February 2006

Dear Colleague

LGPS: Compliance with HMRC Tax Regime from April 2006

You will be aware that ODPM is carrying out a consultation exercise, between 5 December 2005 and 28 February 2006 on a set of draft regulations to amend the LGPS. During this period, ODPM officials and other LGPS interests have been considering in more detail the amendments relating to tax simplification measures which need to be enacted in accordance with the Finance Act 2004 (Parts II and III of the draft SI).

You will recently have received a letter from ODPM seeking your views on a number of policy issues relating to the amendments which will be necessary in complying with the Finance Act 2004. In addition to this, ODPM would like to receive your views on a number of administrative and technical issues (attached) that are associated with these changes. We would be grateful, where possible, if you could respond on these matters as soon as possible, preferably by 10 February so that we are able to more easily proceed. However, responses will be accepted until the close of the consultation exercise on 28 February.

Following this progress, the LGPC will now shortly be able now able to issue pension managers and employers with some advance guidance relating to the tax simplification changes.

Administrators' and other consultees' views will then be incorporated into the final amending regulations and to the LGPC's full guidance. This final guidance will of course only be available once the final amending regulations have been made and laid. This will be some short time before the Finance Act 2004 comes into effect on 6 April 2006, unless proceedings are delayed such that the regulations need to be made and laid with retrospective effect.

Yours faithfully

Brian Town

Matters relating to compliance with HMRC Tax Regime from 6 April 2006 requiring further consideration by pension managers and employers:

Administrative and Technical Issues

1. Unauthorised Payments

It would appear that Compensatory Added Years (CAY) will be treated as unauthorised payments under the new tax regime if paid through the pension fund. ODPM is currently awaiting confirmation from HMRC on this matter, but should this be the case (advice will be conveyed to pension managers and employers asap), it will be necessary to follow one or a combination of the following approaches by 5 April 2006 at latest:

Option A: Administering authorities continue to pay CAY on behalf of employers where necessary, but payments will be charged direct to the relevant employer's bank account. The administering authority will simply act as a payroll processor.

Option B: Administering authorities pay any such CAYs as they are asked to through a separate revenue account. The CAY payments will then subsequently be recharged to the relevant employer or, alternatively, the employer will pay money into the relevant revenue account the day before the CAY is paid.

Option C: Employers will have to pay their own CAYs. The administering authority / pension fund would no longer have any involvement.

Option D: All CAYs will be treated as if awarded under the LGPS augmentation provisions, allowing them to be paid through the pension fund directly (with current recharging built in to ongoing employer contribution rates).

Option E: Allow the flexibility to follow any or a combination of options A, B, C or D.

Question: ODPM is currently minded to proceed according to Option E (this would require the former regulation 143 to be reinstated). Do administrators support this approach or would they favour Option A, B, C, D or some other alternative arrangement?

2. Other payments that may be "unauthorised" under the new tax regime

It would appear that HMRC will deem that other unfunded payments which may currently be made by the administering authority on behalf of employers (such as Crombie, gratuities, injury allowances) will also be treated as unauthorised payments from 6 April 2006 if paid from the Fund and then recharged. Working under this assumption (ODPM is awaiting confirmation from HMRC), administering authorities will no longer be able to pay the amounts from the Fund and instead will either have to charge payments direct to the relevant employer's bank account, or pay through a separate revenue account or pass responsibility for processing the payments back to the relevant employer.

Note: Further changes may be required to remove provisions relating to current payments permitted by the LGPS that would be treated as unauthorised from 6 April. These are generally of a minor nature but, to date, we have identified the following:

- the payment of employee contributions beyond age 75;
- the payment of retirement or death related lump sums beyond age 75;
- the refund of contributions deducted in error (though we are waiting clarification on this);
- the refund of contributions through payroll when a member opts out within 3 months (these will all need to be carried out via the pension fund in future).

Advice on these matters will be conveyed to Pension Managers and employers asap.

3. Trivial commutation

The overriding provisions relating to trivial commutation will also require some amendments to be made to the LGPS. Generally speaking, the overriding provisions require that:

- trivial commutation can only be permitted if the overall value of an individual's pension rights (in all his or her arrangements) is no greater than 1% of the standard lifetime allowance (1% of £1.5 million = £15,000 in 2006/07),
- the payment of all trivial commutation lump sums may only be made within a 12 month period, sometime between age 60 and age 75,
- the payment of a trivial commutation lump sum in a pension scheme extinguishes all rights to benefits in that pension scheme.

The overriding provisions provide that trivial commutation may apply in relation to active and deferred members, as well as pensioners. As a result of these provisions, ODPM could adopt the following approach:

Trivial commutation payments can continue to be paid from the LGPS, subject to the overriding Finance Act 2004 provisions, but only in respect of pensioners, deferred members and pension credit members (i.e. any active member would need to opt out and become a deferred member). The provisions would be strengthened to ensure, however, that a payment was not permitted unless all LGPS benefits were being commuted, including any benefits that might exist in a Scottish LGPS fund.

Question: Do administrators agree?

4. Refund of excess contributions lump sum

The Finance Act 2004 permits a refund to be paid where an individual has paid more contributions than they are entitled to receive tax relief on (i.e. more than 100% of their taxable pay). We propose to incorporate provision to make such payments from LGPS funds.

Question: Do administrators agree?

5. Exceptional ill-health commutation

Regulations to permit the commutation of GMP and Section 9(2B) rights in exceptional ill-health commutation may be forthcoming from the DWP. The tax treatment of exceptional ill-health commutation payments is also treated differently under the Finance Act 2004 as the payment will be counted towards the lifetime allowance. Such a payment can only be made if certification is made by a Registered Medical Practitioner. We propose to amend the LGPS to incorporate these changes and to permit the payment of a lifetime allowance excess lump sum (taxable at 55%) if an individual exceeds their lifetime allowance by payment of the exceptional ill-health commutation.

Question 5: Do administrators agree?

6. Annual allowance

For the purposes of calculating the growth in benefits relating to the LGPS (including AVCs) for comparison with the annual allowance, we propose that we include a provision within the LGPS specifying that the periods should cease on 31 March each year in respect of all current and future members (including members who continue paying AVCs in the future).

Question: Do administrators agree?

If a period end date is not incorporated into the regulations, this will result in:

- periods running to 5 April for current members;
- periods running to anniversaries of date of joining for future members;
- periods running to anniversaries of commencing AVC payments for future members paying AVCs.